

S. Hrg. 107-147

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FEDERAL RESERVE'S SECOND MONETARY POLICY REPORT FOR 2001

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HEARING  
before the  
COMMITTEE ON  
BANKING, HOUSING, AND URBAN AFFAIRS  
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

ON

OVERSIGHT ON THE MONETARY POLICY REPORT TO CONGRESS PURSU-  
ANT TO THE FULL EMPLOYMENT AND BALANCED GROWTH ACT OF 1978

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JULY 24, 2001

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Chairman Sarbanes. Thank you, Senator Bunning.  
Senator Carper.

OPENING STATEMENT OF SENATOR THOMAS R. CARPER

**Senator Carper.** Mr. Chairman, welcome. Far be it for me to carp about your performance and that of the Federal Reserve.

I think you are right on target with respect to your management of our monetary policy. And I am not going to Monday morning quarterback what you do.

Thank you for being aggressive. Thank you for continuing to apply your stewardship to the economic needs and direction of our country and I look forward to your comments.  
Welcome.

Chairman Sarbanes. Thank you, Senator Bunning.  
Senator Carper.

**Senator Carper.** Has Mr. Schumer already gone?

Chairman Sarbanes. But you were here earlier.

**Senator Carper.** I was.

Chairman Sarbanes. For quite a while and then left, and Senator Schumer has just arrived, more or less.

**Senator Carper.** Mr. Chairman, I guess most questions have been asked and probably answered during the time that I was out.

Let me just venture a guess that maybe you haven't spent much time focusing on energy and the implications of the change, the drops in energy prices and what effect that that is having on our economy and is likely to have.

As I look at what is hopefully going to happen here in the second half of the calendar year of the effect of what you have done, the monetary policy has to be kicking in right about now. The effect of the rebates will have some impact, I think a positive one, in the next couple of months. And the effect of the energy policy and the drops in prices.

Certainly, in a psychological sense, they have to have an effect, and also, in a very real dollars and cents sense.

Your thoughts, please.

Chairman Greenspan. Senator, I think it is more than psychological. It is really quite important.

First of all, as I indicated in my prepared remarks, the profit margins were very significantly squeezed by the sharp rise basically in natural gas, electric power, and actually, as I recall, a number of petrochemical feedstock products. The result of that was, in the fourth quarter and especially in the first half, some really significant downward pressure on profit margins. It was a significant part of the increase in unit costs in the consolidated domestic system.

We started, of course, to get very dramatic declines in natural gas prices starting very late last year. We went from, as I recall, \$10 per million BTU's down to approximately three today in the spot market. But remember, businesses use longer-term contracts. And so the contract prices have had much less of a sharp rise and decline. But they are declining. And as I indicated in my remarks, we expect that lower prices of energy, with the exception of electric power, have worked to improve profit margins by lowering costs.

In the household sector, remember the extraordinary problem that we had with respect to natural gas during the winter. The bills that people got were just awesome and unexpected, and there is no doubt that they impacted on consumer expenditures. People pulled back. Those rates are falling. You can see them quite appreciably, to that extent, it is opening up consumer purchasing power.

The gasoline price changes have been really quite dramatic. It was a shortage of refinery capacity earlier this year which prevented the increases in crude inventories being put through the refineries into inventories of gasoline, especially reformulated gas, which caused a big spike in prices, which has now reversed, as the refinery margins, which went up very sharply earlier this year, have now come all the way back down.

And in that regard, even electric power is beginning to ease. It has been an extraordinary event in California, as you know, to run into really quite mild weather. And the combination of conservation in California and the weather has brought down the load factor well beneath sort of a restricted capacity to produce. Now the summer is not behind us yet and there is considerable concern that you can get spikes and they can run into trouble. But we have gotten through a goodly part of the summer with prices very dramatically below where they were. We are talking well under 10 cents per kilowatt

hour in the wholesale market now. And that has been a small fraction of some of the prices we saw back earlier in the year.

**Senator Carper.** Obviously, this is something that you think about a great deal. And I do as well.

I think the factors were aligned, the stars were aligned appropriately earlier this year to, with the energy crisis, particularly with electricity in California, but natural gas and others, the stars were aligned in order to compel us as a Nation to work with our new Administration, our new President, and the Senate and the Congress, to formulate an energy policy that says, let's produce more energy, and as we do that, let's conserve more energy.

And I have a concern now that as the crisis appears to be abating--I filled up with gas yesterday in Harrington, Delaware, Mr. Chairman. I filled it up for \$1.23 a gallon, which I haven't seen for a while, before I came over here----

Chairman Sarbanes. People will be coming from all over the country to buy that gas.

[Laughter.]

**Senator Carper.** And if they come, they can come to the Delaware State Fair, which runs through Saturday, Mr. Chairman.

Chairman Sarbanes. It is the same thing in Salisbury, Maryland, I hasten to add.

[Laughter.]

**Senator Carper.** But Mr. Chairman, my fear is that as the crisis abates, we may let this opportunity to formulate a meaningful energy policy for our country slip away as well.

Do you have any quick thoughts you would want to add on that?

Chairman Greenspan. Senator, I fully agree with that. I think that we have to remember that the reason why energy demand has come off as much as it has is the economy is slowing, and that the world economy being the crucial element in crude oil demand having slowed, has induced a temporary marked rise in crude oil inventories, especially in the United States.

It has given us a sense of, well, there is no particular problem at all. But when you look at it in detail, it gets to be really quite significant in the sense that, with the technologies that we have managed to mount over the last decade or so, we have the capacity to drain natural gas reservoirs at a far faster pace than we did, say, 10, 15 years ago, which means that you have to get a continuously increasing amount of drilling just to stay where you are.

But since we have committed such a substantial part of our new electric power requirements to natural gas, we are running into a long-term problem of how do we square this ability to, one, have natural gas an increasing source within our electric power system, and at the same time have a rate of drilling and new finds of natural gas adequate to meet that overall demand. And I think that we are being sort of tranquilized by the lower price of natural gas. We are not, incidentally, back to where we were 2 or 3 years ago, but we obviously have come off a very extraordinary spike.

So the need to have drilling capacity in the United States is urgent, largely because, unlike oil, we cannot import indefinite amounts. Most of our imports--in fact, the vast proportion--are coming from Canada. And they eventually are going to run into some problems. As I recall, I think a sixth of our demand is met from Canadian natural gas.

Liquified natural gas, which we could effectively bring from anywhere in the world, is a cryogenic, very complex process of transportation which has got a lot of problems and environmental concerns associated with it. Natural gas is a critical issue in this country and we have to, one, focus on how we can conserve it and how we can produce it because we are going to have a problem out there.

The electric power grid infrastructure is obviously something which I think needs to be addressed and that is something which increasingly we are going to become aware needs some major overhaul.

These are issues which you cannot address overnight. They are long-term problems. And unless we address them while we are in fact in temporary surplus, we are going to find that it is going to become really much more difficult and the type of problem which is going to induce us to make the types of decisions which are probably mistakes.

**Senator Carper.** Thank you for your timely and sage counsel very much.

Thank you, Mr. Chairman.